

**DIRECT TESTIMONY
OF
KEVIN B. MARSH
ON BEHALF OF
SOUTH CAROLINA ELECTRIC & GAS COMPANY
DOCKET NO. 2007-229-E**

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COMMISSION

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND POSITION.

A. My name is Kevin Marsh and my business address is 1426 Main Street, Columbia, South Carolina. I am President and Chief Operating Officer of South Carolina Electric & Gas Company ("SCE&G").

Q. DESCRIBE YOUR EDUCATIONAL BACKGROUND AND BUSINESS EXPERIENCE.

A. I am a graduate, magna cum laude, of the University of Georgia, with a Bachelor of Business Administration Degree. Prior to joining SCE&G, I was employed by the public accounting firm of Deloitte & Touche. I joined SCE&G in 1984 and have served as Controller, Vice President of Corporate Planning and, from 1996 to 2006, I served as Senior Vice President and Chief Financial Officer of SCE&G and SCANA. As Vice President of Planning, I oversaw the planning effort that resulted in construction of SCE&G's Cope Station coal-fired generating plant. From 2001-2003, while serving as CFO of SCE&G and SCANA, I also served as President and Chief Operating Officer

1 of Public Service North Carolina. In May of 2006, I was named President and
2 Chief Operating Officer of SCE&G.

3 **Q. HAVE YOU EVER TESTIFIED BEFORE THIS COMMISSION IN THE**
4 **PAST?**

5 A. Yes. I have testified in a number of different proceedings, including
6 proceedings a) to place in rates the last increment of investment subject to the
7 1984 electric capacity phase-in plan (1986), b) to site the Cope Generating
8 Station (1991), and c) to place in rates the Company's investment in the
9 Urquhart Repowering Project (2002) and the Jasper Generating Station (2004).

10 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS**
11 **PROCEEDING?**

12 A. The purpose of my testimony is to report on the state of our Company from an
13 operating standpoint and to provide an introduction to the rate request before
14 the Commission. In my testimony, I also will discuss several of the primary
15 reasons why the Company has filed for this rate increase and the major
16 strategic initiatives SCE&G is undertaking to meet the future energy needs of
17 our customers.

18 **Q. WHAT OTHER WITNESSES WILL THE COMPANY PRESENT?**

19 A. The Company will present the following additional witnesses in this case:

20 **Mr. Stephen Byrne**, Senior Vice President of Generation and Chief
21 Nuclear Officer, who will testify concerning the Company's
22 generation operations and plans to add new capacity.

Dr. Donald A. Murry, PhD who will testify concerning an appropriate cost of capital for the Company.

Mrs. Julie M. Cannell, who will testify concerning financial markets, SCE&G's position in them, and cost of capital.

Mr. Jimmy E. Addison, Senior Vice President and Chief Financial Officer of SCE&G, who will testify concerning the financial posture of SCE&G, the Company's cost of capital and the need for rate adjustments.

Mr. James E. Swan, IV, Controller of SCE&G, who will testify concerning accounting matters and pro-forma adjustments.

Mr. John R. Hendrix, Manager of Electric Pricing and Rate Administration who will testify concerning cost of service and rate design.

SERVICE OPERATIONS AND RELIABILITY

Q. PLEASE DESCRIBE SCE&G'S ELECTRIC SYSTEM.

A. SCE&G operates an integrated electric utility system that serves over 629,000 customers in 24 counties in central and southern South Carolina. SCE&G's service territory includes the metropolitan areas of Charleston, Columbia, Beaufort, and Aiken and many other smaller cities and towns, and rural areas.

Q. HOW HAS SCE&G'S CUSTOMER SERVICE BEEN RATED?

A. In 2006, J.D. Power and Associates once again ranked SCE&G's customer satisfaction in the top 25 percent nationally among both business and

1 residential customers. In March of 2007, J.D. Power and Associates also
2 named SCE&G the highest ranking utility in the South for business customer
3 satisfaction, and third in the nation. The study was based on interviews with
4 representatives from more than 12,900 U.S. businesses. J.D. Power measured
5 customer satisfaction based on six criteria: power quality and reliability,
6 customer service, company image, billing and payment, price, and
7 communications.

8 **Q. WHAT STEPS HAS THE COMPANY TAKEN TO REDUCE THE**
9 **DISRUPTION AND UNCERTAINTY RELATED TO SERVICE**
10 **INTERRUPTIONS?**

11 A. SCE&G now offers its customers an Estimated Time of Outage Restoration
12 (“ETOR”) system to reduce the disruption and uncertainty related to service
13 interruptions. The ETOR system allows customers to phone in during an
14 outage and receive automated real-time updates of the estimated time when
15 service will be restored to them. This is in addition to web-based outage
16 information, including current outage maps, that is available at
17 www.sceg.com/storm.

18 **Q. HOW DOES THE ETOR SYSTEM WORK?**

19 A. The system is fully automated. Crews in the field enter information concerning
20 the repairs required to restore service. The system then estimates the time until
21 service restoration based on the caller’s address and the average time required

1 to complete the type of repairs required. The system has been extremely well
2 received by customers.

3 **Q. WHO DEVELOPED THIS SYSTEM?**

4 A. SCE&G put the components of this system together itself as part of an effort to
5 link its crews in the field through its dispatchers to the customer service
6 personnel in its call centers.

7 **Q. WHAT PROGRAMS DOES SCE&G OFFER TO CUSTOMERS**
8 **EXPERIENCING FINANCIAL DIFFICULTIES?**

9 A. SCE&G has a strong Customer Assistance Program, administered through the
10 customer service department that is specifically dedicated to working with our
11 customers experiencing financial difficulties. SCE&G's goal is always to keep
12 customers connected to the system and receiving service if there is any
13 possibility of doing so. Our account representatives are trained to identify
14 customers who need special assistance with credit and payment problems and
15 to encourage them to come in and speak with one of our specially trained
16 customer assistance representatives. These customer assistance representatives
17 work with local community service agencies and other entities who can provide
18 assistance, and have an excellent track record of locating the kind of assistance
19 needed to keep people in their homes and receiving service.

20 **Q. HOW DID THIS SYSTEM WORK IN THE AFTERMATH OF**
21 **HURRICANE KATRINA?**

1 A. The working relationships that we have established with social services
2 agencies were critically important to the Company's efforts, with this
3 Commission and ORS's assistance, to offer special relief to customers during
4 the period of rapidly rising energy prices in the wake of Hurricane Katrina.
5 During the winter of 2005-2006, more than 10,500 needy customers received
6 \$2.6 million in direct assistance with their bills. This assistance came from
7 funds provided by SCE&G.

8 In recent months, SCE&G has gone even further to strengthen our
9 relationship with social service agencies and to make the process of obtaining
10 assistance for customers more efficient and effective. Last fall we introduced
11 WebPledge, an online tool that allows federal, state, local and private customer
12 assistance agencies to make pledges on behalf of our customers who need
13 assistance paying their utility bills. WebPledge provides qualified agencies a
14 fast, secure way to look up customers' accounts online --with customer
15 authorization in all cases-- and to make pledges of assistance on behalf of
16 customers. The end result is that people receive assistance faster and more
17 efficiently with less chance of service disruption.

18 **Q. WHAT DIRECT ASSISTANCE PROGRAMS ARE SPONSORED BY**
19 **THE COMPANY?**

20 A. SCE&G's Good Neighbor fund is administered and funded exclusively by our
21 employees to assist with non-utility needs of customers who are experiencing

1 financial hardship. Funds are used for a range of issues, from helping purchase
2 prescriptions to paying the deposit on an apartment for a displaced family.

3 Project Share is funded through the generosity of SCE&G employees
4 and customers. It provides assistance to low-income customers for winter
5 heating bills and, in extreme health-related cases, summer bills. Since the
6 program began in 1986, contributions of more than \$6 million dollars have
7 helped more than 40,000 needy customers. The Governor's Office's Division
8 of Economic Opportunity, through community action agencies and the
9 Salvation Army, administers all donations to Project Share, and 100% of the
10 money goes to help those in need.

11 All told, between the two programs --the Good Neighbor Fund and
12 Project Share-- nearly 1,550 individual customers' requests were met in 2006.
13 Over \$400,000 in assistance was provided.

14 **GENERATION OPERATIONS AND RELIABILITY**

15 **Q. HOW WELL HAVE YOUR GENERATING PLANTS OPERATED**
16 **SINCE THE LAST RETAIL ELECTRIC RATE PROCEEDING?**

17 A. As Mr. Byrne will testify, SCE&G has operated its generation system in a
18 reliable and efficient manner since its last electric rate case. During those three
19 years, SCE&G's plant availability factor for its coal plants has been 86%
20 compared to a national average of 88%. As Mr. Byrne will explain in his
21 testimony, the lower availability rate during this period is the result of major
22 maintenance outages and outages to install new environmental equipment.

1 SCE&G's forced outage rate during this period, was significantly lower than
2 the national average (4.4% vs. 5.0%). Availability during the peak summer
3 period was an impressive 97% for these plants.

4 The heat rate of these fossil plants, which is a direct reflection of fuel
5 efficiency, was 9,784 Btu/kWh compared to the estimated national average for
6 calendar year 2006, as published by the Energy Information Administration, of
7 10,022 Btu/kWh. During the last three years, SCE&G's nuclear plant has
8 operated at a standard capacity factor of 91%, and a statutory capacity factor of
9 101% as measured according to the standards set out in S.C. Code Ann. Section
10 58-27-865.

11 **COST CONTROL AND THE CURRENT RATE REQUEST**

12 **Q. WHY IS SCE&G SEEKING AN ELECTRIC RATE INCREASE AT** 13 **THIS TIME?**

14 A. SCE&G continually seeks to mitigate the effect of cost increases in its
15 operations through internal economies, operating efficiencies and other means.
16 However, in spite of these efforts, SCE&G's current return on equity ("ROE"),
17 after accounting and pro forma adjustments, has fallen to 8.27%. As the
18 testimony of Dr. Murry, Mrs. Cannell and Mr. Addison will show, a fair and
19 reasonable rate of return for the Company in today's markets would be 11.75%.
20 To allow the Company the opportunity to earn this return, and to keep the
21 Company on a sound economic footing going forward, a rate adjustment of
22 \$118 million based on test period data is required. Without a rate adjustment,

1 SCE&G's returns will impair the ability of the Company to access capital on
2 reasonable terms going forward. Access to reasonably-priced capital is
3 necessary for SCE&G to continue to maintain a reliable, efficient and safe
4 electrical system to meet the growing need for electricity in its service territory
5 and to meet the increasingly stringent environmental standards that apply to its
6 generating plants.

7 **Q. PLEASE DESCRIBE SOME OF THE THINGS THAT SCE&G HAS**
8 **DONE RECENTLY TO MITIGATE COST INCREASES IN ITS**
9 **OPERATIONS.**

10 A. Our management team and employees constantly seek to reduce costs in ways
11 that are consistent with the long-term interest of our customers in a safe,
12 reliable, and efficient electric system. Some specific steps we have taken to
13 reduce costs to customers in recent years are the following:

14 **Health Care Costs** – As discussed in our last electric rate proceeding,
15 in 2004 the Company embarked on a novel approach to employee wellness.
16 That approach includes a dedicated in-house pharmacy, pharmacists and
17 wellness consultants that travel between our offices, and a wellness center that
18 offers health screening services and prescription counseling to employees,
19 retirees and covered family members. One of the benefits we sought from this
20 investment, beyond the personal benefits to our employees and their families,
21 was a reduction in the Company's health care costs, which had risen by 11.3%
22 or \$4.9 million over the previous 3 years.

1 This initiative has worked as intended. During the last three years,
2 national health care costs rose 12.8%. SCE&G's health care costs, however,
3 rose only 5.3%. Had SCE&G's health care costs risen at the national average
4 during this period, the revenue request in this case would have been \$18
5 million more.

6 **Synthetic Fuels Tax Credits** – As the Commission is aware, SCE&G is
7 the only regulated electric utility which used the Federal Synthetic Fuels Tax
8 Credits it earned by its non-utility operations to defray costs that would
9 otherwise be paid by regulated customers. Other utilities have not shared these
10 benefits with regulated customers but instead recognized the value of their
11 synfuels credits as earnings for stockholders. As of March 31, 2007, SCE&G
12 has used synthetic fuels tax credits to defray 81% of the capital cost of the
13 Saluda Dam Remediation Project, or a total of \$254 million. Had the entire
14 cost of the project been included in rates, the cost to customers in the test year
15 would have increased by \$56 million.

16 I would note that in recognition of its work on the dam remediation
17 project, SCE&G earned the 2006 Outstanding Projects and Leaders ("OPAL")
18 Award from the American Society of Civil Engineers – one of the world's
19 highest civil engineering honors. This project also earned the U.S. Society of
20 Dams' 2006 Award of Excellence and the 2007 Southeastern Electric
21 Exchange Industry Excellence award in the Production Category.

1 **Electric and Gas Capacity Sharing** – In 2006, SCE&G entered into a
2 novel natural gas transportation sharing arrangement between its natural gas
3 and electric generation departments. The Commission reviewed and approved
4 the Memorandum of Understanding (“MOU”) for that sharing in Order No.
5 2006-679 issued in Docket No. 2006-5-G. The MOU provides that the electric
6 and gas departments share 27,000 dekatherms of firm capacity such that the
7 electric department has first call on this capacity during the summer months for
8 generation purposes, and the gas department has first call on that capacity
9 during the winter months. At all times, either department may use capacity not
10 needed by the other on an immediately recallable basis priced at a 100% load
11 factor rate. The MOU saved electric customers \$1.2 million in gas capacity
12 costs during the test period.

13 **Plant Efficiencies** – As indicated above, SCE&G’s plants continue to
14 operate at high levels of efficiency and the combined heat rate of all SCE&G’s
15 coal plants was significantly lower than the average heat rate of coal plants
16 nationally. Had SCE&G’s fossil plants operated at the national average heat
17 rate, the increased cost to customers would have been \$9.5 million in 2006.

18 **Personnel and Efficiency Improvements** – Both our generation and
19 wires (transmission/distribution) business units have taken steps to reduce costs
20 through combining operations and reducing staff. For example, over the past
21 three years the Fossil-Hydro business unit has been able to absorb half the
22 additional employees needed to run the new Jasper Generating Station by

1 reducing numbers in other areas. The total employee count at Fossil-Hydro is
2 only 19 individuals higher than before Jasper Station was added to the system
3 in 2004, even though Jasper employs 38 people.

4 Fossil-Hydro also has installed remote start/stop capability for its gas
5 and oil fired internal combustion turbines which are located at several locations
6 around the system. Previously, if these units needed to be started after hours to
7 meet system need, personnel had to be called out to start the units. The units
8 can now be started remotely by dispatchers, reducing overtime costs and
9 improving responsiveness.

10 For its part, the wires business unit has consolidated all normal dispatch
11 operations, which were formerly disbursed among crew quarters, into
12 centralized dispatch centers in Columbia and Charleston. This consolidation of
13 dispatch has reduced upward pressure on staffing which, as discussed below,
14 has been particularly intense for distribution operations given the growth taking
15 place on the electric system and the aging of the Company's workforce.

16 SCE&G also has standardized the configuration and stocking of service trucks
17 throughout its service territory. This creates efficiencies in set-up, stocking and
18 training and makes all of our trucks seamlessly inter-changeable throughout the
19 system.

20 **Summer Station Switchgear Repair** – In 2005, the Company was able
21 to repair a 230,000 volt switch at the Summer Station switchyard without
22 shutting down the plant. Thermal imaging had shown that the switch was

1 failing. But working “bare handed” on 230,000 volt equipment while
2 energized or “hot” is not something that is customarily done in the Southeast.
3 Our transmission personnel located a crew from outside the Southeast that had
4 experience in working at these voltages. This crew was able to repair the
5 switch in question without the necessity of a two or three day outage at
6 Summer Station. Keeping Summer Station on line saved substantial fuel costs
7 that would otherwise have been passed through to customers.

8 **New Delivery Terminal for Off-Shore Coal** – As the Commission is
9 aware, in 2005 the Company experienced significant problems with the
10 railroads that failed to make contractually required deliveries of coal. These
11 problems threatened to interfere with the reliable operation of SCE&G’s most
12 intensively used coal-fired generation plants. In addition, coal prices have
13 fluctuated in the past several years and in some periods coal from off-shore
14 producers has had a lower delivered cost than domestic coal. Furthermore,
15 SCE&G’s principal rail contracts are expiring in the near future, and railroads
16 are expected to seek significant increases in their charges.

17 In response to all these things, SCE&G has constructed a barge off-
18 loading facility at Williams Station, on the Cooper River, upstream from
19 Charleston Harbor. This facility allows off-shore coal to be shipped to
20 Charleston Harbor, off-loaded onto barges at mid-channel in the lower reaches
21 of the Cooper River, and then brought up the Cooper River to the new off-
22 loading facility at Williams Station. The facility can also accommodate

1 deliveries of limestone needed for SCE&G's scrubbers. Coal, lime, and
2 limestone off-loaded at Williams Station can also be shipped by truck to other
3 generating units.

4 This new facility improves SCE&G's access to off-shore coal when
5 market conditions are favorable and when railroads are unable to make the
6 deliveries needed to support reliability. The facility also gives SCE&G a
7 second option for coal supply as the contracts with railroads are renegotiated.

8 **Conclusion** –The specific savings from many initiatives cannot be
9 quantified. However, it is possible to make reasonable estimates of the savings
10 from the health care initiative, the crediting of synthetic fuel tax credits to the
11 dam project, the gas/electric MOU, and the above-average heat rate efficiencies
12 at our top fossil plants. All told, those efforts have resulted in costs reductions
13 worth approximately \$85 million to our retail electric customers on an annual
14 basis, based on test year data.

15 **Q. WHY THEN IS A RATE CASE NEEDED?**

16 A. In spite of the Company's efforts to control costs, there have been a number of
17 offsetting items in the Company's operations and finances that have made it
18 necessary for the Company to seek rate relief at this time. As Mr. Addison
19 explains in his testimony, it is hard to single out specific cost or expense items
20 in isolation as creating the need for rate relief. However, from my perspective
21 overseeing operations of the Company, I can point to several major items that

1 have made a significant contribution to the need for rate relief in this case.

2 Those things include:

- 3 • Investment in transmission and distribution infrastructure, particularly
4 investment needed to meet rapid development in parts of our service
5 territory;
- 6 • Investment in generating plants, particularly investment in environmental
7 upgrades; and
- 8 • Increases in things such as tree trimming costs, costs of materials and
9 supplies and labor costs.

10 Increases in these and other categories have resulted in the need to seek a rate
11 adjustment at this time.

12 **CUSTOMER GROWTH AS A FACTOR IN THIS CASE**

13 **Q. PLEASE DESCRIBE THE GROWTH SCE&G HAS EXPERIENCED IN**
14 **ITS SERVICE AREA SINCE THE LAST RATE PROCEEDING.**

15 **A.** In the three years since the test period in SCE&G's last retail electric rate case
16 (Docket 2004-178-E), SCE&G's electric distribution system has been
17 expanding rapidly to meet development in its service areas. During those three
18 years, SCE&G has added approximately 56,000 new customers to its electric
19 system. But in rapidly developing areas, most of the required electric
20 infrastructure must be installed long before the majority of the customers who
21 will use that infrastructure have bought homes and opened accounts. As a
22 result, customer growth is a lagging indicator of electric system growth.

1 **Q. HOW MUCH ADDITIONAL DISTRIBUTION INFRASTRUCTURE**
2 **HAS SCE&G INSTALLED SINCE ITS LAST RATE PROCEEDING?**

3 A. During the most recent three-year period, SCE&G added 1,000 new circuit
4 miles to its distribution system, an increase of 6.3%. During that period,
5 SCE&G set 52,000 new poles; 17,000 of which were new-business only poles,
6 *i.e.*, poles in places where SCE&G had no pre-existing lines. During this time,
7 SCE&G added 20,000 new street lights, and 29,000 new distribution
8 transformers.

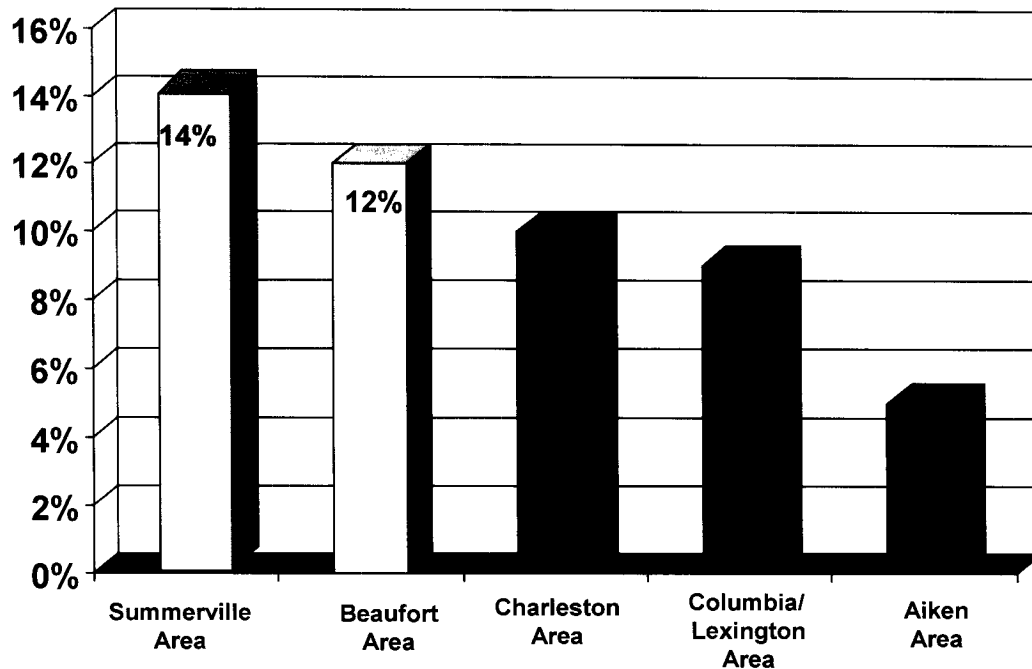
9 **Q. WHERE IS THIS GROWTH CONCENTRATED?**

10 A. While significant growth is occurring in the Northeast Columbia and Lexington
11 areas, and in some areas around Aiken and North Augusta, the most rapid
12 growth on our system is occurring in the coastal regions, the areas around
13 Charleston, Mount Pleasant, Summerville, and Beaufort. Sixty percent of the
14 growth we have experienced in the past three years has occurred in our coastal
15 districts. Two local offices in those districts experienced growth in excess of
16 25% --Ridgeland at 33%, and Summerville at 27%. The only non-coastal
17 office with similar growth rates was Lexington with 32% customer growth
18 during that period. The following chart shows the growth rates in distribution
19 customers by area:

1

2 **SCE&G: 2004 - 2007**

3 **Customer Growth by District**



13 **Q. HOW IS THIS DEVELOPMENT DIFFERENT FROM DEVELOPMENT**

14 **IN THE PAST?**

15 A. Coastal development has historically been clustered on the ocean-front or

16 marsh-front or areas within a short distance from them. In the past, the limited

17 amount of buildable land located in these areas and the high cost of that land

18 limited development. But in recent years the market has changed. Immediate

19 proximity to the marsh or ocean is not nearly as important as it once was.

20 Much of the current development is occurring on large tracts of land that are

21 several miles inland from the coast. Often large 'pioneer' tracts in previously

undeveloped areas are developed first. Then smaller residential and commercial developments begin to fill in the areas around them.

Q. HOW DOES THE GEOGRAPHY AND ENVIRONMENT OF THE COASTAL REGION AFFECT THE ECONOMICS OF SERVING GROWTH THERE?

A. Building new electric infrastructure to serve growth along the coast is expensive. In coastal areas, wetlands, marshes and river crossings are common. Permitting and environmental compliance costs are high. Along the coast, there is no electric system to the east, and marshes and rivers often cut off access to infrastructure to the north or south. As a result, redundant radial feeds are often the only way to build a reliable electric system in many places. In addition, new coastal transmission structures cost more because they are built to withstand winds of at least 150 miles per hour.

Q. HAVE OTHER FACTORS AFFECTED THE RECENT LEVEL OF INVESTMENT IN SCE&G'S DISTRIBUTION AND TRANSMISSION SYSTEMS?

A. Yes. Two other factors have increased the amount of capital invested in our transmission and distribution system. They are inflation in the costs of materials and supplies, and the aging of much of SCE&G's existing infrastructure.

1 **Q. HOW HAS INFLATION AFFECTED THE COST OF EXPANDING**
2 **AND MAINTAINING THE DISTRIBUTION AND TRANSMISSION**
3 **SYSTEMS?**

4 A. During the last three years, inflation has increased the cost of transformers,
5 pole hardware, conduit, and other materials used in our distribution operations
6 by approximately 30%-45%. The cost of underground and overhead
7 distribution wire has increased by over 150%. These increases reflect the
8 increase in the cost of copper, aluminum, plastic, steel, and fuels generally, as
9 well as the increased global demand for these materials.

10 **Q. HOW HAS THE AGE OF THE TRANSMISSION SYSTEM AFFECTED**
11 **INVESTMENT IN IT?**

12 A. Much of SCE&G's transmission system was built in the period between the
13 late 1940's and late 1970's, when the great majority of our present generation
14 stations were built and when the major load centers in our service areas were
15 being fully integrated into a single transmission system. In many areas, the
16 capacity for future growth that was built into these assets thirty or forty years
17 ago has been exhausted. In addition, aging physical assets require increased
18 capital investment to maintain their reliability.

19 **Q. HOW HAS THIS INVESTMENT IN DISTRIBUTION AND**
20 **TRANSMISSION INFRASTRUCTURE AFFECTED SCE&G'S RATE**
21 **BASE?**

1 A. In the three years since the last test period, the Company's total capital
2 spending for transmission and distribution assets has been \$496 million. This
3 has resulted in an increase in transmission and distribution rate base, net of
4 depreciation and retirement costs, of \$326 million. Our Chief Financial
5 Officer, Mr. Addison, will provide a more comprehensive explanation of the
6 principal financial matters underlying this request. But this \$326 million net
7 increase in distribution and transmission rate base, coupled with the increase in
8 taxes, depreciation and O&M associated with it, is a major driver of the
9 Company's need for additional revenue.

10 **OTHER INVESTMENTS AND COST DRIVERS**

11 **Q. WHAT ARE SOME OF THE OTHER INVESTMENTS MADE IN**
12 **SCE&G'S SYSTEM?**

13 A. During the past three years, SCE&G has invested \$290 million in capital
14 improvements to its generating plants. Of this amount, \$123 million was for
15 environmental improvements. The remainder was for other capital investments
16 to maintain and update the Company's nuclear and fossil-hydro plants. This
17 level of investment is not unexpected given that Summer Station is now 25
18 years old, and the average age of our coal plants is now 38 years.

19 **Q. WHY IS THIS LEVEL OF GENERATION INVESTMENT**
20 **SIGNIFICANT?**

21 A. Investment at this level was necessary to meet environmental mandates and to
22 maintain older plants as valuable, efficient and reliable generating assets.

1 However, this investment reflects required capital spending that generates no
2 new megawatts and produces no new electricity to serve customers.
3 Historically, in the years between the construction of new plants, depreciation
4 on generation assets outstripped new capital investment in existing plants. As a
5 result, depreciation reduced the net book value of the generation rate base each
6 year, often by substantial amounts. This reduction in net rate base helped the
7 Company in its efforts to absorb cost increases due to inflation and other causes
8 without rate increases.

9 However, during the past three years, new capital investment in existing
10 plants equaled approximately 88% of the depreciation taken on generation
11 assets. As a result, during recent years, depreciation has not put significant
12 downward pressure on rates as was often the case during past periods when
13 new plants were not being built.

14 **Q. WHAT ARE SOME OF THE OTHER FINANCIAL CHANGES**
15 **UNDERLYING THE NEED FOR RATE ADJUSTMENTS?**

16 A. Over the past three years, the Company's expenses for tree trimming, for
17 example, have increased significantly. Part of the increase is caused by
18 increased costs charged by tree trimming crews (for whom fuel is a major
19 expense). Part is due to increasingly stringent vegetation management
20 standards issued by the National Electric Reliability Council ("NERC") as part
21 of its reliability initiatives in the wake of the Northeastern blackout of 2003.
22 Additionally, part of the increase is caused by SCE&G's commitment to

1 maintain a tight tree trimming schedule to limit the effects of ice and wind on
2 the reliability of its service. Overall, annual tree trimming costs have increased
3 by \$4 million since the last rate case.

4 Another factor in the current rate case is labor costs. Labor costs are
5 subject to inflation. In addition, growth in our service territory requires
6 additional employees in areas like customer service engineering and line crews.
7 Also, our business is becoming more complex and highly regulated each year
8 as Federal Energy Regulatory Commission (“FERC”) regulations, Nuclear
9 Regulatory Commission (“NRC”) regulations, environmental regulations,
10 NERC reliability regulations, Sarbanes-Oxley compliance, and similar
11 requirements become more demanding and complicated.

12 In addition to the effects of regulation, SCE&G is like many other
13 American businesses in that it has an aging workforce. We have looked out
14 several years and see that many workers with experience and skill sets that are
15 key to our business will retire soon. This problem is evident among our
16 distribution and transmission line crews where skilled crews are a necessity for
17 maintaining reliability, for restoring storm damage and for ensuring the safety
18 of operations. To maintain a reliable, safe and efficient electric utility system,
19 SCE&G has begun hiring apprentices and trainees before the experienced
20 workers they will replace retire. This will give the new hires time to learn
21 SCE&G’s system and the skills they need before experienced workers retire.

1 All the costs listed above are investments SCE&G is making in its
2 continued ability to meet the demands of its customers and to operate its system
3 in a safe, efficient and reliable manner. While SCE&G always seeks to
4 economize its operations, we manage our business to meet the energy needs of
5 the State of South Carolina and the customers we serve over the long term.
6 Where investments are required to meet long-term needs efficiently, the
7 Company is prepared to make those investments.

8 **PENDING CAPITAL PROJECTS AND STRATEGIC CHALLENGES**

9 **Q. PLEASE DESCRIBE THE MORE IMPORTANT CAPITAL PROJECTS**
10 **THAT THE COMPANY ENVISIONS IN THE NEXT SEVERAL**
11 **YEARS.**

12 A. There are two major categories of capital projects that the Company is
13 undertaking at present. The first consists of environmental upgrades at three of
14 our largest coal plants. This group of projects involves the installation of
15 scrubbers at Wateree and Williams Stations to reduce SO₂ emissions and
16 installation of a Selective Catalytic Reactor ("SCR") unit at Cope to reduce
17 NO_x emissions. Construction should be underway on all of these upgrades at
18 the time of the hearing in this case and it is anticipated that these projects will
19 be concluded by the end of 2009. The total cost for these scrubbers and the
20 SCR unit is \$450 million.

21 The second major capital project is the planned construction of
22 additional nuclear capacity at Summer Station. The capacity in question would

1 be built adjacent to the current Summer Station unit. The South Carolina
2 Public Service Authority (“Santee-Cooper”), which owns a one-third share of
3 Summer Station Unit 1, has agreed to participate in the new capacity. At the
4 time this testimony is filed, the Company has not yet signed a contract to
5 engineer, procure and construct this capacity, but is actively pursuing such a
6 contract. In his testimony in this proceeding, the Company’s Senior Vice
7 President for Generation and Chief Nuclear Officer, Mr. Byrne, will discuss the
8 reasons why the Company has chosen to pursue nuclear capacity at this time
9 and where SCE&G and Santee-Cooper stand in procuring that capacity.

10 **Q. ARE THE COSTS FROM THESE PROJECTS REFLECTED IN THE**
11 **CURRENT CASE?**

12 A. By and large, they are not. The only costs related to these capital projects that
13 are reflected in rates are the costs associated with \$8 million in construction
14 work in progress related to the Cope and Wateree environmental upgrades. As
15 to nuclear capacity, SCE&G has removed \$10 million in Construction Work in
16 Progress from the current rate proceeding through a pro forma adjustment.
17 This amount represents SCE&G’s portion of the expenditures to date for new
18 nuclear capacity.

19 On the other hand, in its rate application, SCE&G has added into its
20 capital structure through a pro forma adjustment approximately \$275 million in
21 debt SCE&G plans to issue in 2008. That debt will finance part of SCE&G’s
22 investment in environmental upgrades and part of its initial investment in

1 designing, permitting and constructing nuclear capacity. This pro forma
2 adjustment does not result in any additional costs to customers. Instead, the pro
3 forma adjustment has reduced the rate request in this proceeding by increasing
4 the debt component in the capital structure of the Company which in turn
5 lowers the cost of capital on which the rates are calculated.

6 **Q. WHAT BEARING, THEN, DOES THE CURRENT CASE HAVE ON**
7 **THESE PROJECTS?**

8 A. Ultimately, whether SCE&G is able to proceed with these investments and
9 finance them efficiently depends on whether the financial community will
10 make the necessary capital available to SCE&G on reasonable terms. The
11 order issued in this proceeding will largely determine the degree to which the
12 investment community sees the Commission as supporting or not supporting
13 the Company's financial position as it undertakes these investments. As other
14 witnesses will explain in more detail, the perceived support or lack of support
15 for the Company's financial position –particularly in so far as the allowed ROE
16 in this case is concerned– will be critical to whether SCE&G will be allowed to
17 raise capital on reasonable terms to support these projects. Without that
18 capital, SCE&G will find it very difficult to meet the needs of its customers for
19 reliable, efficient electric service in future years.

20 **Q. DO YOU HAVE ANY CONCLUDING COMMENTS?**

21 A. In conclusion, I would say that electric rate proceedings have often come at
22 critical turning points in the history of SCE&G's electric business. We are at

1 such a point now. The costs that underlie this rate application reflect
2 investments in the people and assets that are necessary for SCE&G to operate a
3 reliable and efficient electric system today and into the future. In addition,
4 SCE&G is firmly convinced that it must continue to invest in its system and
5 service in order to meet the current and future needs of its customers. I
6 respectfully request that the Commission grant the rate relief requested by the
7 Company and affirm its support for the investments that the Company is
8 making to meet its electric utility obligations.

9 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

10 **A.** Yes. It does.

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